

## Wisconsin Supreme Court Clarifies Required Assessment Methodology for Section 42 Housing

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The Wisconsin Supreme Court recently rejected the city of Racine's property tax assessments in *Regency West Apartments LLC v. City of Racine*, 2016 WI 99, clarifying in important respects the appropriate assessment methodology for I.R.C. § 42 low-income housing tax credit properties.

*Regency West* concerned the 2012 and 2013 assessments of a newly constructed 72-unit Section 42 housing development. For 2012 (the first tax year following completion of construction), the city assessed the property at \$4,425,000, using the direct capitalization of income approach. This approach divides the property's net operating income (NOI) by the applicable capitalization rate. Established case law requires assessors to use the subject property's actual income and expenses, not market rates, when assessing properties subject to federal programs like Section 42. See *Metro. Holding Co. v. Bd. of Review of City of Milwaukee*, 173 Wis. 2d 626, 631-32, 495 N.W.2d 314 (1993). Because *Regency West* did not have actual income and expenses for the period prior to 2012, it provided the city with its projected income and expenses for the property. The assessor refused to use the projections, however, and instead calculated the NOI using market rate data. In addition, the assessor derived the capitalization rate from sales of market rate properties rather than from sales of other Section 42 properties, as *Regency West* argued was required.

For 2013, the city assessed the property at \$4,169,000 based primarily upon the comparable sales approach. The city relied on three comparison properties. One of the comparison properties consisted predominantly of market-rate apartments with only a few Section 42 units. The other two comparisons consisted exclusively of HUD § 8 rent-subsidized units. *Regency West* argued that none of the assessor's comparison sales met the threshold comparability test because none were subject to restrictions similar to the subject property, and the comparable sales approach, therefore, should not have been utilized.

The Supreme Court agreed with *Regency West* and rejected the city's assessments for both years. With respect to the city's income valuation for 2012, the Court first reiterated that, when calculating the NOI for Section 42 properties, assessors must use income and expense data specific to the property. Where, as here, new construction is being assessed, the Court held that projected income and expenses for the subject property provide the best information available; the assessor may not utilize market-rate data. In addition, the Court held it was an error to derive the capitalization rate from sales of market-rate properties instead of limiting consideration to sales of Section 42

properties.

With respect to the 2013 assessment, the Court held that, as a matter of law, market-rate properties may not be used as comparisons in assessing Section 42 properties. The Court similarly held, as a matter of law, that HUD § 8 properties are not reasonably similar to Section 42 properties and may not be used for a comparable sales approach in assessing Section 42 properties, since the two types of properties are not subject to the same types of restrictions.

In addition to rejecting the city's assessments, the Court also approved the alternative valuations provided by Regency West's expert, which relied solely upon the direct capitalization of income approach to conclude that the value of the subject property was \$2,700,000 for 2012 and \$2,730,000 for 2013. The Court held that Regency West's expert's valuations complied with Wisconsin law and specifically rejected the city's contention he erred in utilizing a single valuation method, noting it is appropriate to do so when there is only one reliable method.

In a footnote, the Court indicated it gave no consideration to the appraisals of the city's outside experts because they exceeded the city's original valuations, citing *Trailwood Ventures, LLC v. Vill. of Kronenwetter*, 2009 WI App 18, ¶¶ 12-13, 315 Wis. 2d 791, 762 N.W.2d 841. The city has filed a motion for reconsideration, asking the Court to eliminate this footnote; the city of Milwaukee has filed a request to file a non-party brief supporting Racine's motion. The Supreme Court has not yet ruled on the reconsideration motion, which does not challenge the Court's holdings in the case.

The *Regency West* case has important implications for Wisconsin owners of Section 42 housing, as well as owners of projects subject to other federal government housing programs. Owners should be sure to have a thorough understanding of the assessment methodology used by their local assessors and make sure the approach conforms with the requirements set forth by the Supreme Court in *Regency West*. Assessors are currently working on 2017 assessments, and there may be an opportunity to reduce assessments without litigation.

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